Decl. ¶ 17; Andersen Report 7-8. Because the coin equipment is "necessary" for the phone to exist at all -- and thus to be available for the subscriber 800 and access code calls from which carriers profit -- the costs of providing the coin equipment are joint and common, and thus properly allocable across all calls.

Besides, if one were to hypothesize that PSPs used coinless rather than coin-capable payphones, the "cost" of carrying subscriber 800 and access code calls would *go up* and would *exceed* the cost of carrying local coin calls. As Andersen explains, this occurs because a large portion of joint and common costs, including the cost of the line, is normally allocated to coin calls. If one assumes a coinless phone, however, no portion of those costs can be allocated to coin calls, as coin calls simply cannot be made. Andersen Report at 7.

4. The Commission Must Add Any Costs Unique to Subscriber 800 and Access Code Calls

An appropriate avoided cost model must account not only for costs that carriers help PSPs *avoid* by virtue of the fact that these calls are dial-around and subscriber 800 calls, but also for any costs that carriers *impose* on PSPs for the same reason. Here, those costs may prove substantial.

In particular, two interexchange carriers -- relying on paragraph 64 of the Order on Reconsideration -- are arguing that the Commission should impose a very expensive burden on PSPs. These carriers argue that, to be eligible for per-call compensation, each PSP payphone must be identified by the LEC switch with a "70" ANI ii digit identifier for COCOT lines, a "29" for inmate lines, and a "27" for coin lines. See Response of AT&T and MCI to LEC ANI Coalition Ex Parte Dated June 16, 1997, at 4 (FCC, filed Aug. 13, 1997). This, however, would be tremendously expensive. The USTA estimates that, even if Flex ANI rather than more expensive hard-coding were used, it would cost over $700 million to modify LEC switches to meet this demand.[4] More important here, AT&T and MCI insist that the entire cost of this new ANI ii digit delivery service be absorbed by PSPs pursuant to LEC tariffs. Id.; see also Recon. Order, 11 FCC Rcd at 21266, ¶ 64 (payphone identification service to be "tariffed" to PSPs).[5]

As Professor Hausman and Arthur Andersen both explain, the cost of meeting this demand is chargeable, and represents an additional cost unique to subscriber 800 and access code calls. Andersen Report at 5-7; Hausman Decl. ¶ 16. Consequently, both Professor Hausman and Arthur Andersen have calculated the impact of these costs (if the Commission were to impose them) on the per-call compensation amount. The impact is significant: Meeting AT&T and MCI's demands would add in the range of $.05 to $.08 to the cost of each compensable call, far more than the cost of the coin collection and termination charges that such calls avoid. Andersen Report at 7. Consequently, if the FCC were to require compliance with AT&T and MCI's commands, the per-call compensation rate would have to exceed the local coin rate by at least $.01 to $.04. See Hausman Decl. ¶ 16.[6]

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4. Letter from Keith Townsend, Director, Regulatory Affairs & Counsel, USTA, to William F. Caton, FCC, CC Docket 96-128 (filed July 28, 1997).

5. Indeed, it would be unlawful for the Commission to attempt to impose this cost on LECs. Section 276 expressly prohibits cross-subsidies from LEC local exchange operations to PSPs. Consequently, the full cost of whatever requirements are imposed ultimately will be borne by PSPs.

6. Requiring hard-coded digits, as AT&T previously demanded, would add even greater costs. According to Arthur Andersen's estimates, it would add approximately $.07 to $.11 per call. Andersen Report at 7. Even if payphone identification can be provided with either Flex ANI or OLNS, at each individual LEC's choice -- as originally contemplated in the Commission's OLS Order, see Policies and Rules Concerning Operator Service Access and Pay Telephone Compensation, 11 FCC Rcd 17021 (1996) -- an increase in the per-call compensation rate would be required. Andersen estimates that, if each LEC were allowed to choose between OLNS and Flex ANI (so each could elect the method that is most economical for it) and the costs were charged against PSPs, subscriber 800 and access code call costs would increase by an average of $.01 per call. Andersen Report at 7.

In the Coalition's view, the appropriate course is for the Commission to avoid imposing these costs at all. As the Coalition elsewhere has explained, additional ANI ii digits are neither necessary nor even desirable for per-call compensation to proceed. Moreover, it is physically impossible to modify all LEC switches to send these digits within the time frame currently set forth. Consequently, the Commission should refrain from imposing this costly, unnecessary, and inappropriate result.[7] If this cost is imposed, however, the per-call compensation rate must take it into account.[8]

5. The Total Net Avoided Cost Approach Requires Pricing Above the Local Coin Rate

Once all of these costs are accounted for, the net avoided cost model produces, on average, a per-call compensation rate that is greater than the local coin rate:

Avoided Costs		
Cost Type	**Mean**	**Modal**
Local Usage	- $.02	$.00
Coin Collection	- $.02	- $.03
ANI ii	+$.05 to $.08	+$.05 to $.08
TOTAL	**+$.01 to $.04**	**+$.02 to $.05**

Thus, far from producing too much compensation, setting the per-call rate equal to the local coin rate yields too little compensation.

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7. Because all of the relevant data and arguments are set forth in the LEC ANI Whitepaper of June 16, 1997, and the USTA's <u>ex parte</u> of July 28, 1997, the Coalition does not repeat the arguments here, but incorporates them by reference instead.

8. Coalition members will be working with the carriers to attempt to develop a mutually acceptable way of avoiding the imposition of this unnecessary cost on PSPs.

This result is wholly consistent with the results that would be reached under a fully-allocated costing methodology. As Andersen explains, even under a fully-allocated, average cost theory, non-coin calls on average -- once ANI ii costs are taken into account -- are more costly than local coin calls. Andersen Report at 13. And even if ANI ii costs are (improperly) excluded, the difference between coin and non-coin call costs is no more on average than $.04 per call. Ibid.

B. The Commission Also Must Adjust "Fair Compensation" Rates to Account for Differing Prices and Price Elasticities of Demand

As Professor Hausman explains in his declaration, net avoided cost pricing does not entirely account for all of the differences between local coin calls on the one hand, and subscriber 800 and access code calls, on the other hand. In particular, it entirely omits one important determinant of pricing -- the conditions of demand. Hausman Decl. ¶¶ 6, 10, 14, 32. Because of this omission, avoided cost-pricing does not properly mirror the pricing results -- and the efficiency -- that the market would achieve if left to its own devices. To the contrary, it will result in undercompensation and the uneconomic removal of payphones. Ibid.

In markets with high joint and common costs, goods are rarely priced on a strict cost basis. To the contrary, competitors typically price goods and services based not merely on cost, but on demand elasticity as well. See Hausman Decl. ¶¶ 20-21. In particular, they tend to load cost recovery onto products and services for which demand is relatively less elastic, decreasing the price (and thus enhancing demand) for products and services that are more price-elastic. Thus, airlines -- which operate in a cut-throat market -- do not charge business and vacation travelers rates that are based strictly on the difference in the cost of providing them with service. Instead, airlines tend to charge business travelers relatively more, causing them to make a relatively greater contribution to joint and common costs as well as profits, because their elasticity of demand is lower. Id. ¶ 20.

This leads to efficient and social-welfare maximizing results: Because of its relative inelasticity, demand for business travel is not substantially reduced, while the shifting of cost-recovery to business travelers allows airlines to lower the price for pleasure travel, increasing what otherwise might be low demand. Id. ¶ 20. This type of pricing methodology, referred to as "Ramsey" pricing or "inverse elasticity pricing," has been recognized as efficient by both the Commission and the Court of Appeals.[9]

The inverse elasticity pricing principle must be taken into account when comparing the prices of local coin, access, and dial-around calls. As Professor Hausman explains, the cost of carrying a payphone call, like the cost of transporting an airline passenger, mostly consists of joint and common costs, a condition that causes marginal costs to be lower than average costs. As a result, typical market conditions would cause different types of payphone calls to be priced relative to each other not only based on cost, but also based on elasticity of demand. In

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9. Describing in part the FCC's rationale for adopting pricing baskets under its price caps scheme, the Court of Appeals has observed that strict cost-based pricing is not appropriate where "marginal costs are below average costs." National Rural Telecom Ass'n v. FCC, 988 F.2d 174, 182 (D.C. Cir. 1993). Under such circumstances, "inverse elasticity" pricing or "Ramsey" pricing maximizes social welfare:

> The price increments over marginal cost are allocated in inverse proportion to the price elasticity of demand for the good or service, with increments relatively high for services for which demand is inelastic, low for those for which demand is elastic. The upshot is to minimize the aggregate impact of the price increments on consumer demand and thereby maximize consumer surplus. [In establishing its price cap system, the] Commission clearly adopted this basic understanding.

Ibid. The maximization of social welfare and consumer surplus, of course, are simply the terms that economists use to describe the goals that Congress has commanded the Commission to pursue here -- the promotion of competition and the "widespread deployment of payphone services to the benefit of the general public," 47 U.S.C. § 276(b)(1).

particular, the payphone industry -- like the airline industry -- would tend to "load" joint and common costs into services for which demand is less elastic. Hausman Decl. ¶¶ 20-21.

Here, the industry would tend to load cost recovery onto dial-around and subscriber 800 calling, increasing the price of those calls relative to local coin rates. As the Coalition explained before, the relatively higher prices charged to purchasers of 800 service and access code calls make those calls less sensitive to the same absolute change in price:

> [L]inking per-call compensation to the local rate systematically results in undercompensation. This is true because local calling volumes are more sensitive to *absolute* changes in price than are long-distance calling volumes. An absolute increase of, for example, a dime on a local call represents a substantial percentage change in price (in the range of 40 percent). Because such a dramatic percentage change in price will profoundly influence demand, there is substantial pressure not to alter the local rate in such an increment. In contrast, an extra dime on a long-distance call would represent a relatively small change in price (perhaps 5 percent) and thus would have a negligible effect on demand.
>
> Based on these different dynamics, rational actors in a fully competitive market would avoid depressing demand for local calls by loading costs into long-distance prices -- and the interexchange carriers would end up paying *more* than the local rate as compensation for use of PSP phones. By *linking* interexchange prices to local rates, however, the Commission's order prevents PSPs from using this pricing mechanism and favors interexchange carriers with lower prices than the market otherwise would offer.

RBOC Coalition Opposition to Petitions for Reconsideration at 7-8 (Oct. 28, 1996) (citations omitted).

Both John Haring, the former Chief Economist of the Common Carrier Bureau, and Professor Jerry Hausman agree with this analysis. SPR Report at 31-33; Hausman Decl. ¶¶ 19-32. Indeed, there already is proof that the market would price in this manner. Just like subscriber 800 and access code calls, 0+ calls do not impose local usage or coin collection costs on PSPs. Yet the market price for those calls (charged as commissions to IXCs) *exceeds* -- and often is several times -- the price of a local coin call. While PSPs in deregulated states only charge $.35 for local coin calls, for 0+ calls the average commission is in the range of $1.00. See Hausman Decl. ¶ 22; Andersen Report at 9, 12.

For this reason, it is absurd to suggest that the market would price subscriber 800 and access code calls using a discount for avoided cost. It does not price 0+ calls -- which cost PSPs the same amount to originate as subscriber 800 and access code calls -- in that manner. Consequently, there is no reason to believe that the market would price subscriber 800 and access code calls under an avoided cost formula either. Hausman Decl. ¶ 22.

Instead, the market would price access code and subscriber 800 calls at a rate above the local coin rate, just as it does with the 0+ calls that are carried at identical cost. As Professor Hausman concludes, "once demand conditions are considered -- as would occur in a competitive industry -- no reason exists to claim that the per-call compensation rate should be less than the local coin call price. To the contrary, as the calculation based on 0+ calls demonstrates, dial-around and 800 subscriber calls would have a higher competitive price than local coin calls." Hausman Decl. ¶ 28. In fact, using competitive mark-up analysis, Professor Hausman estimates that a competitive market would price access code and subscriber 800 calls at $.42 to $.43 per call, or $.07 to $.08 above the prevailing local coin rate. Id. ¶¶ 28-29, 47.[10]

Failure to adjust per-call compensation to take account of this "inverse elasticity" pricing will result in less competition and fewer payphones. As Professor Hausman explains, taking these principles into account results in an "economically efficient solution." Id. ¶ 30. It enhances competition and consumer welfare by allowing PSPs to recover their costs in the same

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[10]. Professor Hausman's ad valorem tax model, which allocates joint and common costs among different call types based on the revenues generated thereby, also confirms that efficient pricing would require per-call compensation rates in excess of the local coin rate. Under this model, subscriber 800 and dial-around calls would be priced at approximately $.37 per call. Andersen Report at 13.

manner as they would absent regulatory intervention. See id. ¶ 32. In contrast, failure to take account of these principles, and setting the per-call price below the local coin rate, will result in the removal of payphones that a fully competitive market would have supported. Id. ¶ 10, 32. Even at a per-call compensation rate of $.35, twenty percent of all payphones are at risk of removal, and each penny reduction below $.35 will cause the removal of thousands more. Id. ¶ 45; Andersen Report at 13 n.15. Such sub-market pricing and sub-market payphone supply would be directly contrary to the results -- "competition" among PSPs and "widespread deployment of payphone services to the benefit of the general public," 47 U.S.C. § 276(b)(1) -- that Congress directed the Commission to achieve.

For these reasons, the Commission cannot set access code and subscriber 800 call prices below or even at the local coin rate based on perceived cost comparisons. Instead, to achieve an efficient and competitive allocation of payphones consistent with Congress's mandate, it must establish a per-call rate that exceeds the local rate by $.07 to $.08.

C. The Commission's Prior Analysis Confirms that Per-Call Compensation Must Be Set Above the Local Coin Rate

Consistent with the market-based approach employed by the Commission in the Report and Order and adhered to in the Remand Notice, the Commission in its 1992 Second Report and Order also established per-call compensation rates using market proxies. In particular, the Commission determined that it was a "reasonable approach" to calculate per-call compensation for access code calls based on "AT&T's 0+ commissions." Second Report and Order, Policies and Rules Concerning Operator Service Access and Pay Telephone Compensation, 7 FCC Rcd 3251, 3257, ¶ 37 (1992) ("Second Report and Order"). Using data furnished by non-RBOC

PSPs, the Commission estimated that the average AT&T commission was, and set compensation at, \$.40 per call. Id. at 3257, ¶ 40.[11]

This approach makes sense. There is no better measure of the value of receiving calls than the amount OSPs are willing to pay for such calls in a free and open market place. See SPR Rep. at 33-34. Moreover, because the amount OSPs are willing to pay (and non-RBOC PSPs are able to charge) for presubscribed calls is determined by market forces, the result is fair: Neither party would enter into the transaction if it were "unfair" from their perspective. See SPR Report at 33-34; NPRM, 11 FCC Rcd at 6726, ¶ 16 & n.54; Report and Order, 11 FCC Rcd at 20567, ¶ 49.

Accordingly, the Coalition has commissioned Arthur Andersen to produce an updated report on commissions paid by AT&T for operator services traffic for independent PSPs similar in size to the Coalition PSPs. See Andersen Report at 8-13. Andersen's calculations indicate that, on average, AT&T pays a commission of between \$.78 and \$1.14 per call, or between 36 and 54 percent of the average revenue generated by each call. Id. at 12.

AT&T's commissions (as estimated by Arthur Andersen), however, may not be fully indicative of market rates. Consequently, Andersen performed a similar study of commissions earned by PSPs similar in size to those operated by Coalition members. Andersen estimates that the commissions earned by those carriers range from \$.90 to \$1.33 per call. Id. at 9.

AT&T and other carriers have argued, however, that using these commissions -- which are in the range of \$1.00 -- as an estimate for per-call compensation on subscriber 800 calls might be inappropriate. It is one thing to require a carrier to pay a dollar or more for calls that, like access code calls, generate on average \$2.16 in revenues. It is quite another thing to impose a one dollar charge on subscriber 800 calls which, according to AT&T, on average generate less than \$.50 in

[11]. It makes sense to look at commissions paid to non-RBOC PSPs rather than RBOC PSPs because RBOC PSPs, until very recently, were forbidden from negotiating directly with IXCs.

revenue each.[12] Accordingly, Andersen has developed a methodology to account for the different revenue amounts produced by each call type.

In particular, Andersen calculated how much is paid, as a percentage of revenue generated, for access code calls. It then calculated an estimate of what market-based commissions would be for subscriber 800 calls by applying the same percentage commission to the lower revenue generated by those calls. Because it is technically infeasible to price subscriber 800 and access code calls differentially -- many access code calls are placed through 800 numbers -- Andersen blended these two results, producing an estimate of the "average" market commission for all call types.

Thus, using commissions paid to PSPs as the baseline, Andersen estimates that the typical 0+ call produces between \$.90 and \$1.33 per call (between 36 and 54 percent of revenue), but subscriber 800 calls would trigger payments of just \$.18 to \$.27 per call (36 percent to 54 percent of average revenue of \$.50 per call). Andersen Report at 9. If subscriber 800 calls are assumed to outnumber access code calls 2-to-1 (a favorable assumption for carriers since the ratio is sometimes closer to 3-to-2), the blended rate turns out to be between \$.43 and \$.63 per call. Andersen Report at 10. Even if one uses the more conservative AT&T commission estimates, the blended rate is between \$.39 and \$.57 per call. Id. at 13.

These figures exceed the prevailing local coin rate in deregulated states. The Commission's prior market- and commission-based methodology, adjusted to take into account subscriber 800 calls, thus shows that using the local call rate as a proxy for "fair" compensation tends to produce compensation that is lower than, not higher than, the market rate.

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12. We have reason to believe that this estimate is low, but have used it for illustrative purposes nonetheless. In any event, it is important to bear in mind that a vast universe of toll-free calls are made from residence and business lines, for which no per-call compensation is due.

D. The Commission Should Not Resort to Periodic, Full-Blown Cost Proceedings to Set Per-Call Compensation

The Commission's decision to avoid artificial, accounting-based measures of cost was well reasoned and, despite vigorous attack from interexchange carriers,[13] left undisturbed by the Court of Appeals. Nonetheless, various carriers inevitably will argue that the Commission must or should return to a cost-based methodology instead of the market-based proxies the Commission has used before. Because the Court did not remand the Commission's reasoning for using market-based proxies, there is no reason for the Commission even to address these arguments.

If the Commission does address them on the merits, however, they should be rejected for the same reasons the Commission gave before: Simply put, they yield results that cannot be reconciled with Congress's command to deregulate the industry and ensure the "widespread deployment of payphone services to the benefit of the general public." 47 U.S.C. § 276(b)(1).

First, relying on a cost-based methodology would drastically reduce the number of payphones available to the public. Any feasible, cost-based methodology must, by necessity, rely on average costs and average call volumes; one cannot very well calculate a cost-basis for each and every phone. These components of the cost-per-call calculation vary widely among providers, locations, and phones. SPR Report at 26-27.[14] A compensation rate based on average costs and average volumes thus would lead those payphones with high call volumes (and high

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13. See, e.g., Joint Brief of IXCs at 30 (contending that the FCC's "decision to treat deregulated rates as surrogates for costs" was flawed); id. at 36 (challenging the FCC's rejection of cost-based rates).

14. Arthur Andersen has calculated that, among Coalition members, the average cost per call can be as high as $.34 per call for all calls (and as high as $.37 per call for local coin calls) in one Coalition member's region, but still be only $.28 per call for all calls (and $.29 for local coin calls) in another. Andersen Report at 13 n.13. Moreover, independent PSPs, which often have different equipment, often will have wholly different cost structures than many LEC PSPs. People's Telephone Company, for example, has estimated that its average cost is $.45 per call. See Report and Order, 11 FCC Rcd at 20564-65, ¶ 45.

revenues) or low costs to flourish. But any phones with less than average calling volumes (which, by definition, will be somewhere around half of existing payphones) and/or above average costs (again, about half) would be at risk of removal because they cannot recover total costs. See id. at 27.

This decline in payphone numbers would not only be contrary to congressional command -- including an express injunction that "widespread" payphone availability be promoted -- but also would be detrimental to social welfare. As Professor Hausman and Arthur Andersen explain, even a $.35 rate puts over 20 percent of all payphones at risk, and every penny reduction below $.35 translates directly into the removal of thousands more payphones. See Hausman Decl. ¶ 45; Andersen Report at 13 n.15.[15]

The Commission therefore was entirely correct to conclude that "a cost-based compensation standard could lead to a reduction in payphones by limiting PSP's recovery of its costs, and this result would be at odds with the legislative purpose of Section 276 [to] 'promote the widespread deployment of payphone services to the benefit of the general public.'" Recon. Order, 11 FCC Rcd at 21267, ¶ 66. Instead, the Commission appropriately selected a market-based approach that would accommodate the "likely cost" and other "variations" from "payphone to payphone" and region to region. Id. at 21268, ¶ 71.[16]

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15. The only feasible and economically rational cost-based alternative is to set prices based on the costs and volumes of the most marginal payphone, which is what the market would do. Hausman Decl. ¶¶ 39-41. That, however, would set rates far above the rates being proposed by the Coalition under the remaining methodologies.

16. To the extent some carriers reassert their absurd plea for compensation linked to "marginal cost," that too was properly rejected. If prices for all calls were priced at some measure of incremental cost, the joint and common costs that make up a majority of payphone costs could not be recovered. Indeed, arguing that PSPs should earn only their marginal cost for carrying these calls is like arguing that hotels should be compensated only for the cost of washing the sheets and vacuuming the carpet after each guest, with no compensation for the cost of building, maintaining, and staffing the hotel. As AT&T's own former expert has explained, basing prices

Second, as the Commission twice has recognized before, cost-based compensation poses obvious administrative difficulties related to compiling and analyzing PSP cost data, and it requires the Commission to make considerable assumptions about economic allocations. Id. at 21266, ¶ 66 ("it would be particularly burdensome to impose a TELRIC-like costing standard" -- or any cost-based standard -- "on independent [PSPs] who have not had previous experience with any costing systems"); Second Report and Order, 7 FCC Rcd at 3255-56, ¶ 32 (similar conclusion). Indeed, it would be particularly difficult to rationalize the wide divergence of existing cost structures -- for RBOC PSPs, independent PSPs, and carriers such as AT&T -- into a single, cost-based rate.

More important, as cost structures change with technology over time and economic conditions shift, the Commission would have to adjust its methodology and its results continuously, turning what is supposed to be a competitive, market-based industry into a highly regulated, cost-based one. See ibid.; see also Hausman Decl. ¶¶ 42-43. Indeed, the Commission at regular intervals would have to embroil itself in highly contentious, time-consuming cost-accounting and rate-setting proceedings. The Commission therefore was correct to reject the costs of such a methodology as "completely disproportionate to any benefits offered by [the] approach." Second Report and Order, 7 FCC Rcd at 3256, ¶ 32.[17]

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on marginal cost in an industry typified by fixed costs is a "recipe for bankruptcy." Strategic Policy Research, Critique of the Hatfield Cost Analysis at 3 (attached to Reply Comments of BellSouth Corporation, CC Docket 96-128 (FCC July 15, 1996)).

17. Moreover, basing per-call compensation on a cost per-call model would require the Commission to predict a specific level of demand. But a higher price will depress demand (i.e., the number of calls), requiring a still higher rate to satisfy revenue requirements. Accurately calibrating the equilibrium point in a period of change of this magnitude will prove not merely difficult, but impossible.

Third, gathering the cost data for independent PSPs may prove especially difficult, as the Commission has concluded before. Id. at 3255, ¶ 32. The Commission cannot simply rely on RBOC cost data as a basis for setting compensation for the independent PSPs. The costs of RBOC PSPs have been skewed by regulatory considerations and the technology the RBOCs have employed; as a result, they are not a fair surrogate for the costs of independent PSPs. If the Commission wants to set per-call compensation based on costs, then each company will have to have its own per-call rate based on its own costs and based on the cost of each phone.[18]

Fourth, and in any event, the Coalition has commissioned Arthur Andersen to calculate average cost data for the Coalition as a whole. As the Andersen Report shows, if ANI ii costs are taken into account, the Coalition-wide average per-call cost for coinless calls exceeds the per-call cost of coin calls. Andersen Report at 13. Thus, even average costing results support setting per-call compensation above the prevailing local coin rate.

E. The Commission Must Set Per-Call Compensation Rates at Least $.07 Above the Competitive Coin Rate

Thus, far from producing too much compensation, setting the per-call compensation at the local coin rate produces too little. Whether measured using avoided costs, average costs, inverse elasticity, or the Commission's previously used proxies, these approaches suggest that the market

18. The Commission gave a particularly detailed set of reasons for rejecting the TELRIC methodology touted by AT&T. In addition to the above reasons, the Commission explained that TELRIC was designed to "enable competitors to take advantage of an incumbent monopolist's 'economies of scale, scope, and density, and thus rapidly to acquire potentially bottleneck elements that they cannot promptly supply themselves.'" FCC Br. at 50 (quoting Recon. Order, 11 FCC Rcd at 21267, ¶ 67). Unlike local exchange facilities, payphones cannot even conceivably be construed as bottlenecks, and there are no significant economies of scope or scale. Recon. Order, 11 FCC Rcd at 21267, ¶ 67. Moreover, TELRIC can only be applied efficiently where there are few joint and common costs. For dial-around, subscriber 800, and all other payphone calls, however, almost all costs are joint and common. This renders TELRIC particularly difficult and inappropriate to use for payphones. Ibid.

rate of compensation -- and thus the "fair" and efficient level of compensation -- for subscriber 800 and access code calls is at least $.07 more than the local coin rate.

Per-Call Compensation Under Different Methodologies	
Methodology	**Results**
Inverse Elasticity	Local Coin Rate + $.07 to $.08 ($.42 to $.43)
0+ Commissions (Adjusted for Subscriber 800 Revenue)	Local Coin Rate + $.08 to $.28 ($.43 to $.63)
AT&T 0+ Commissions (Adjusted for Subscriber 800 Revenue)	Local Coin Rate + $.04 to $.22 ($.39 to $.57)
Avoided Cost (with ANI ii)	Local Coin Rate + $.01 to $.05 ($.36-$.40)

Failure to set compensation levels commensurate with these results will result in fewer payphones than the market otherwise would provide and the loss of social welfare. Hausman Decl. ¶¶ 32, 39-41. Even at $.35, over 20 percent of all Coalition payphones are at risk, and thousands more will be removed for each penny that compensation falls below $.35. Id. ¶ 45. Rural payphones, which tend to be the most expensive and have the least volume of calls, will be particularly hard hit. This is precisely what Congress sought to avoid when it directed the Commission to "promote the widespread deployment of payphone services to the benefit of the general public." 47 U.S.C. § 276(b)(1).

This stands in stark contrast to the impact that a relatively higher per-call compensation rate will have. The per-call compensation rate set by the Commission will act as a ceiling rather than a floor. Any rate set by the Commission will merely be a default rate, and parties will be free to depart by negotiation. Because TOCSIA effectively precludes PSPs from negotiating for a higher rate, however, the market cannot adjust the rate upward if the default is too low. If the rate is generous, however, the IXC's potential to block calls gives them leverage to negotiate for a lower price (as the Commission and the Court of Appeals both agreed). Recon. Order, 11 FCC Rcd at 21268, ¶ 71; Illinois Pub. Telecom., slip op. at 15. Thus, in the event the Commission inadvertently sets the rate "too high," the market is fully capable of adjusting the rate downward.

Because too generous a rate will result in negotiations, while too low a rate will not, the Commission must exercise great caution not to establish an insufficient default rate that would preclude market negotiations and inevitably lead to the removal of payphones, the loss of economic efficiency and social welfare, and great inconvenience for the American public.

II. THE COMMISSION MUST IMPOSE A FULLY COMPENSATORY AND FAIR INTERIM COMPENSATION MECHANISM [Remand Notice pp. 3-5]

A. Interim Compensation for 800 and Access Code Calls Must Be Fairly Calculated and Appropriately Allocated [Remand Notice pp. 3-4]

As the Commission notes in its Remand Notice, the Court remanded the interim compensation plan for reconsideration of both the interim rate calculation and the allocation of interim obligations among carriers. Remand Notice at 3; Illinois Pub. Telecom., slip op. at 17. We address each of these two issues in turn.

1. The Interim Rate and Flat-Rate for Subscriber 800 and Access Code Calls Should Be Calculated Using the Same Methodology as Before

In the Report and Order, the Commission established a two-stage interim compensation plan. During the first period, while carriers were setting up their systems for tracking calls (so as to be able to pay true *per-call* compensation), carriers would pay monthly, flat-rate compensation for each payphone. Report and Order, 11 FCC Rcd at 20568, 20578, 20601, ¶¶ 51-52, 72, 119. During the second period, which was to last one year, carriers were to pay true per-call compensation, but at a Commission-established rate. Id. at 20567-68, ¶ 51.

Relying on its conclusion that the deregulated coin rate was an appropriate proxy for "fair compensation," the Commission used the "modal" local coin rate in states where the coin rate was deregulated to establish interim compensation obligations. Illinois Pub. Telecom., slip op. at 8, 17; Report and Order, 11 FCC Rcd at 20570, ¶ 56. In particular, it established flat-rate compensation during the first period by multiplying an estimate of the average number of calls per month per payphone, id. at 20603-04, ¶ 124, by the modal deregulated coin rate of $.35, yielding a per-payphone rate of $45.85 per month, id. at 20604, ¶ 125. During the second half of the interim compensation period, carriers would pay a true *per-call* rate of $.35.

Setting aside the Commission's allocation of this burden, the Court of Appeals gave only one reason for remanding this system: The fact that the Commission's interim system, like its permanent per-call compensation system, had linked the per-call compensation amount to the local coin rate without properly justifying that linkage. Illinois Pub. Telecom., slip op. at 17; Remand Notice at 3. As explained above, however, reasoned economic analysis supports setting the per-call compensation rate at the local coin rate plus $.07 to $.08. Using this figure, the Commission can establish the interim compensation rate much as it did before.

In particular, the Commission should multiply the per-call compensation rate it selects (based on the prevailing local coin rate in deregulated states plus appropriate elasticity and cost-based adjustments) by the average number of access code and subscriber 800 calls per month per payphone. Using the Commission's previous estimate of 131 calls per payphone per month, Report and Order, 11 FCC Rcd at 20602, ¶ 120, this means multiplying a per-call rate of no less than $.42 by 131, producing flat-rate interim compensation of $55.02 per payphone per month. During the second part of the interim period, the per-call rate should be set above the local coin rate, again at no less than $.42 per call. Finally, after the interim period ends, the per-call compensation rate should be set at the local coin rate plus no less than $.07 per call.

2. All Industry Participants Should Pay Their Fair Share of the Interim Compensation Obligation

In addition, the Court of Appeals remanded the Commission's allocation of interim compensation obligations. In particular, the Commission had allocated the $45.85 per line charge only among IXCs with over $100 million in toll revenues for the first year of the plan, and it had based the allocation on total toll revenues. Report and Order, 11 FCC Rcd at 20601, ¶ 119; Recon. Order, 11 FCC Rcd at 21290-91, ¶ 126. The Court remanded this allocation for two reasons. First, in the Court's view, the Commission had not adequately justified its exclusion of smaller IXCs from paying interim compensation. Second, the Commission had not justified allocating the obligation among IXCs in proportion to total toll revenues.

The Coalition believes that, notwithstanding the Court's order, administrative convenience still has a role to play. The Commission simply cannot be expected to calculate exact allocations of per-call compensation for even the smallest of carriers, especially in the absence of any reliable data regarding the volume (or the types) of calls they carry. Accordingly, carriers with less than $1 million in toll revenues per month should be exempt. On average, their contribution to the interim-compensation plan would be too insubstantial to justify the administrative effort necessary to identify them, estimate their share, and ensure payment. But carriers with toll revenues of more than $1 million per month should have the critical mass necessary to make their inclusion both administratively possible and economically sensible.

The Commission also has asked whether LECs should contribute toward interim compensation. Remand Notice at 4. Subject to the size limitation set forth above, the Coalition can see no principled reason why LECs should be excluded. The Commission's per-call compensation system extends not only to interstate or interLATA calls, but also to intrastate and intraLATA toll calls; there seems to be no reason why the interim compensation obligations should not extend to intrastate and intraLATA toll calls as well. Accordingly, to the extent LECs carry intraLATA subscriber 800 or intraLATA access code toll traffic from payphones and for which the market otherwise cannot provide compensation, LECs (with toll revenues in excess of $1 million per month) should make a fairly-calculated contribution as well.

B. The RBOCs and GTE Should Receive Appropriate Compensation for 0+ Calls During the Interim Period [Remand Notice pp. 4-5]

The Court of Appeals also remanded the Commission's treatment of compensation for 0+ calls during the interim period. With respect to permanent compensation, the Commission had determined that, for RBOC and GTE payphones, 0+ calls should be compensable because RBOC and GTE PSPs otherwise would not receive "fair" compensation for "each and every" call as required by statute. Report and Order, 11 FCC Rcd at 20569-70, ¶ 55; Illinois Pub. Telecom., slip op. at 6. In particular, the Commission recognized that, for many years, the RBOCs (and GTE) had been barred from participating in carrier selection and thus were precluded from obtaining compensation for 0+ calls through the market. Although the RBOCs and GTE are now allowed to participate in carrier selection, long-term contracts between location owners and IXCs -- grandfathered by Section 276 -- still preclude them from obtaining "fair" compensation on 0+ calls. Accordingly, the Commission required carriers to pay per-call compensation to RBOC PSPs for 0+ calls "so long as they do not otherwise receive compensation for use of their payphones in originating 0+ calls." Report and Order, 11 FCC Rcd 20567-68, ¶ 51; Recon. Order, 11 FCC Rcd at 21259, ¶ 51.

This decision was not challenged on appeal, and the Court took no issue with it. To the contrary, the Court remanded the interim compensation mechanism to the Commission because the Commission failed to apply the same reasoning to provide compensation for 0+ calls to the RBOCs, to GTE, and to similarly situated PSPs, during the interim period. This failure to provide compensation on an entire category of calls during the interim period, the Court held, "is patently inconsistent with § 276's command that fair compensation be provided for 'each and every completed . . . call.'" Illinois Pub. Telecom., slip op. at 19; see also Remand Notice at 4.

The Coalition agrees with the Commission that the Court's concern extends only to situations where the market, because of current or prior regulatory intervention, does not provide PSPs with compensation for 0+ calls. This would occur where, as is the case for the RBOCs and GTE, prior regulation barred the PSP from negotiating for per-call compensation on 0+ calls,[19] and existing contracts between the carrier and the location provider prevent such negotiated market transactions from providing that compensation today.

The Commission also has requested comment "on how the BOCs, and any other similarly situated PSP, should be compensated during the interim period for 0+ calls for which they do not receive compensation by contract." Remand Notice at 4. In particular, the Commission asks whether it is appropriate to take into account the fact that the presubscribed carrier on such a payphone "often pays a commission on such calls to the location provider." Ibid. The only conceivable adjustment that could be made to the per-call compensation rate applicable to access code and subscriber 800 calls, to make it appropriate for 0+ calls from RBOC and GTE payphones, is to increase it.

As the Commission repeatedly has pointed out, the market normally is best situated to determine what compensation is "fair." Report and Order, 11 FCC Rcd 20567, ¶ 49; Illinois Pub. Telecom., slip op. at 7. In the case of 0+ calls -- the very call type at issue here -- the market has set a "fair" compensation rate. Andersen has estimated the range as being between $.78 and

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[19] See United States v. GTE Corp., No. 83-1298 (HHG), 1988 U.S. Dist. LEXIS 16525, 1988-2 Trade Cas. (CCH) ¶ 68,369 (D.D.C. Dec. 23, 1988) (prohibiting GTE from selecting the presubscribed carrier for its payphones, as the Court had with respect to the RBOCs before).

$1.33 per call. Andersen Report at 9, 12. Because the per-call compensation rate for dial-around and subscriber 800 calls set by the Commission is unlikely to reach that amount, applying the subscriber 800 and dial-around rate to 0+ calls from RBOC and GTE payphones already imposes an enormous (and largely unjustifiable) discount. Accordingly, no further "discount" -- whether based on commissions to location providers or otherwise -- can be justified. To the contrary, the only change that can be justified is an *increase* over the access code and subscriber 800 per-call compensation amount.

Finally, the Commission has asked commenters to address tracking for these 0+ calls. The Coalition agrees that, because the presubscribed carriers on RBOC and GTE payphones already track and bill their clients for 0+ calls, they should be able to track and pay per-call compensation for them as well. In the event the carriers disagree and would like to use an alternative, flat-rate mechanism for the interim period, the Coalition has calculated, and includes with the Andersen Report (at 15), the average monthly 0+ call volume from their payphones.

C. The RBOCs and GTE Must Be Afforded Fair Interim Compensation for Inmate Payphones [Remand Notice p. 5]

For the same reasons it faulted the Commission for failing to provide RBOC and GTE PSPs with interim compensation for 0+ calls made from their payphones, the Court also faulted the Commission for failing to provide RBOC and GTE PSPs with interim compensation for 0+ calls made from their inmate payphones. Illinois Pub. Telecom., slip op. at 19-20; Remand Notice at 5. The Coalition believes that the same interim compensation mechanism that is applied to their non-inmate payphones should apply to their inmate payphones as well. Estimates of 0+ calling volume from inmate payphones similarly are provided in the Andersen Report (at 16).

D. The Commission May Make Retroactive Adjustments to Interim Compensation Levels [Remand Notice p. 5]

The Commission also has asked for comments regarding retroactivity. In particular, it has asked whether any changes to per-call compensation levels should be retroactive, and if so, whether they should be retroactive back to the start of the interim compensation period or to the date of the Court of Appeals' decision. Remand Notice at 5.

Compensation for RBOC and GTE 0+ and Inmate Calls. In the Coalition's view, the Commission has no alternative but to make the adjustments to interim compensation on 0+ calls and inmate payphones retroactive to the start of the interim compensation period (for LECs, April 15, 1997). The Court of Appeals held, in no uncertain terms, that the Commission's failure to provide compensation for these calls was "patently inconsistent" with Congress's express command to afford compensation for "each and every" call. Illinois Pub. Telecom., slip op. at 19. Indeed, the failure to provide per-call compensation on these calls would be particularly inappropriate inasmuch as the Commission has removed the subsidies formerly used to support them. See 47 U.S.C. § 276(b)(1)(B) (subsidies formerly used to support LEC payphone operations to be eliminated "in favor of" per-call compensation). Because the Commission is without authority to refuse to provide the compensation that Congress required, its decision regarding compensation on 0+ calls and inmate payphones must be retroactive to April 15.

Compensation for Subscriber and Access Code Calls. Consistent with this principle, the Coalition also believes that changes to the per-call compensation amount also should be retroactive, consistent with other governing principles. One could argue that, while the statute requires PSPs to be "fairly" compensated for each and every call, it nowhere requires that the allocation of the compensation burden among carriers meet any particular criteria. The Administrative Procedure Act, however, requires that the allocation not be arbitrary, and the

Commission has authority to impose a retroactive remedy to "undo what has been wrongfully done by virtue of [a prior] order that has been upset on judicial review." Natural Gas Clearinghouse v. FERC, 965 F.2d 1066, 1073 (D.C. Cir. 1992) (internal quotation marks omitted). Indeed, the D.C. Circuit has held that an agency has authority to allow the imposition of retroactive surcharges on customers where the agency's prior order arbitrarily prevented rates from being lawfully raised. Id.[20] Accordingly, the principled approach would be to make, and the Commission should make, all adjustments retroactive to the beginning of the compensation period.[21]

III. THE COMMISSION MUST VALUE LEC ASSETS AT NET-BOOK VALUE [Remand Notice pp. 5-7]

Finally, the Court of Appeals vacated and remanded with respect to asset valuation, holding that the Commission's decision to require fair-market valuation of assets transferred to a separate subsidiary violated the principles of Democratic Central Comm. v. Washington Metro. Area Transit Comm'n, 485 F.2d 786, 806 (D.C. Cir. 1973), cert. denied, 415 U.S. 935 (1974). In particular, the Court held that the Commission's requirement of fair market valuation impermissibly sought to transfer the value of shareholder assets to ratepayers. Illinois Pub. Telecom., slip op. at 27. Under Democratic Central, the Court held, shareholders were entitled to

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20. Neither the filed rate doctrine nor the related prohibition on retroactive ratemaking stands as an independent barrier to this remedy. Those doctrines do not apply because no rate was ever "filed" or accepted by the Commission. Moreover, even where a rate is filed and accepted by the Commission, if the rate is later held to be unlawful, damaged parties are permitted to sue for the difference.

21. For similar reasons, the Commission also must ensure that carriers make timely compensation payments. To date, some carriers have made no payments to LEC PSPs. Willful failure to make required payments should result in the imposition of interest charges, penalties, and ultimately sanctions. This is especially important for LEC PSPs, who have given up monthly compensation through the CCLC. Making them wait for quarterly compensation -- or for years on end with no compensation -- would be inconsistent with Congress's desire to replace the CCLC with per-call compensation.

any increase in value in payphone assets because, under price caps, they had borne the risk of loss associated with them. Ibid.

The Commission tentatively has concluded that "[t]he Court appears to hold that net-book value must be used for one-time transfers" that result from industry reform, a description that "would apply to payphone asset transfers." Remand Notice at 7. The Coalition largely agrees. Because any transfer of payphone assets to a separate affiliate is a one-time reform, the Commission's asset transfer rules, which are aimed at "on-going" and "systematic" transfers between affiliates, simply do not apply. Illinois Pub. Telecom., slip op. at 27-28. Instead, the Commission must use net-book value, the methodology it consistently has used when detariffing CPE in the past,[22] that is mandated under GAAP,[23] and that repeatedly has been used and approved by the courts.[24]

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22. Report and Order, Procedures for Implementing the Detariffing of Customer Premises Equipment and Enhanced Services (Second Computer Inquiry), 95 F.C.C.2d 1276, 1306 (1983) ("Section Computer Inquiry"), aff'd in relevant part, AT&T Information Systems v. FCC, 854 F.2d 1442, 1446 (D.C. Cir. 1988); Seventh Report and Order, Procedures for Implementing the Detariffing of Customer Premises Equipment and Enhanced Services (Second Computer Inquiry), 59 Rad. Reg. 2d (P&F) 949, ¶ 10 (1986) (CPE belonging to independent telephone companies "must be transferred to unregulated accounts or a separate subsidiary at net book value on the date of deregulation"); Eighth Report and Order, Procedures for Implementing the Detariffing of Customer Premises Equipment and Enhanced Services (Second Computer Inquiry), 3 FCC Rcd 477, 483, ¶ 50 (1988) (applying net-book valuation to transfer of LEC CPE because "[t]he net book value standard has been used consistently and successfully throughout this docket").

23. See Arthur Andersen, Calculation of Per-Call Compensation and Review of Accounting and Regulatory Treatment for Payphone Asset Reclassification, July 1, 1996, at 19 (such transfers "accounted for at historical cost" (i.e., net book)) (quoting Accounting Principles Board Opinion No. 16, Business Combinations; Accounting Interpretation No. 39, Transfers and Exchanges Between Companies under Common Control) (attached to Comments of the RBOC Payphone Coalition (FCC July 1, 1996)).

24. See, e.g., United States v. AT&T, 552 F. Supp. 131, 204-05 (D.D.C. 1982) (finding "no justification for abandoning the well-established practice of valuing assets at net book"); AT&T Information Systems, 854 F.2d 1442, 1446 (D.C. Cir. 1988) (use of net-book value held to be "an acceptable -- and accepted -- basis for the detariffing process").

CONCLUSION

The Commission has an opportunity, indeed a mandate, to launch the payphone industry on its way to becoming a fully competitive market. It is critical that each of the decisions in this rulemaking be made with that goal in mind. As Congress expressly concluded, competition, not regulation, is the best means of "promot[ing] the widespread deployment of payphone services to the benefit of the general public." 47 U.S.C. § 276(b)(1). Consistent with that goal, the Commission should establish per-call compensation rates that are commensurate with those that the market itself would establish. Because the market provides the best insight into that pricing, the Commission should begin with the competitively-determined prevailing local coin rate and, considering elasticity of demand and other factors the market would take into account, establish per-call compensation rates above the local coin rate.

Indeed, as demonstrated above, the market price for subscriber 800 and access code calls would be at least \$.07 to \$.08 above the local coin rate. See Part I-B, supra. Even avoided cost analysis (which is less than fully efficient, will undercompensate PSPs, and will reduce the number of payphones available for public use) places the price of compensation as much as at \$.05 above the local coin rate. See Part I-A, supra. And all of the Commission's previous methodologies from 1992, even after adjustment to account for the lower revenue potential of subscriber 800 calls, place the per-call rate at between \$.04 and \$.25 above the local coin rate. See Part I-C, supra. Because the market would price access code and subscriber 800 calls at rates that are at least \$.07 to \$.08 above the local coin rate, the Commission should do so as well.